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FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D., 1940.

NO. 291

EQUITABLE LIFE INSURANCE COMPANY OF IOWA,
Petitioner,

vs.

HALSEY, STUART & CO., A Corporation, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

JOSEPH G. GAMBLE,
ALDEN B. HOWLAND,
500 Bankers Trust Building,
Des Moines, Iowa,
Attorneys for Petitioner.

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SUMMARY OF ARGUMENT.

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The so-called "hedge clause" of the offering circular in which respondent represented that "all statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we, ourselves, have relied upon them in the purchase of this security," cannot be construed to relieve respondent from liability for misrepresentations recklessly made through means other than the offering circular itself 20, 23

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A.

Where positive representations are made which are true when made, but while the transaction is pending conditions substantially change, to the knowledge of the party making the original representations, good faith and common honesty require that the party making the representations advise the other that the change has taken place, and failure to disclose the fact of such change constitutes actionable fraud 21, 31

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AUTHORITIES CITED.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D., 1940.

NO._____

EQUITABLE LIFE INSURANCE COMPANY OF IOWA,
Petitioner,

vs.

HALSEY, STUART & CO., A Corporation, *Respondent.*

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

TO THE HONORABLE SUPREME COURT OF THE UNITED STATES:

Petitioner, Equitable Life Insurance Company of Iowa, respectfully shows to this Honorable Court:

SUMMARY STATEMENT OF THE MATTER INVOLVED.

Petitioner, a life insurance company organized under Iowa laws, brought this action in the Northern Illinois District against respondent, Halsey, Stuart & Co., an Illinois corporation dealing in bonds and securities, for damages of $250,157 because of fraud practiced upon petitioner in the sale of bonds of local improvement districts of the City of Longview, Washington.

The evidence upon the trial disclosed that respondent, known to petitioner, and its officers, as one of the nation's leading bond and investment houses, about May 1, 1930,

offered to petitioner, as an investment for its policy reserves, a block of Longview, Washington local improvement bonds. Respondent's salesman Kelley first delivered to F. W. Hubbell, petitioner's Vice President and treasurer, an offering circular describing the bonds, Exhibit 1. (R. 171, 410-413, inc.) This circular described the bonds as payable from the proceeds of special assessments levied upon benefited property. It contained the following statement:

> "Longview is situated about 133 miles south of Seattle at the confluence of the Columbia and Cowlitz Rivers. It has a frontage of 7¼ miles on the former, and is a port of call for ocean-going vessels midway between Portland and the Pacific Ocean. * * * Because of its natural advantages and proximity to the timber stands of the Long-Bell and Weyerhaeuser interests, Longview was selected as the site for the vast lumber manufacturing plants of these companies. The present output of the Long-Bell plants is 1,800,000 board feet per day. The Weyerhaeuser plants are under construction. Manufacturing plants have also been erected by other concerns, including the Longview Concrete Pipe Company, the Pacific Straw Paper & Board Company, the Magor Car Corporation, the Standard Oil Company, Longview Paint & Varnish Company, and the Central Mill Works. The first unit of the plants of the Longview Fibre Company, to cost two and one-half million dollars, is now well under way."

The circular contained the following notation in fine print:

> "All statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we ourselves have relied upon them in the purchase of this security." (R. 413)

Kelley stated that the bonds, in addition to being municipal securities, were unconditionally guaranteed by Long-Bell Lumber Company, a very large and long-established lumber manufacturing company. (R. 170) After examin-

ing the circular, Hubbell asked Kelley for more information concerning the City of Longview, what the property was out there, and about the Long-Bell Lumber Company. (R. 187, 188) In response to such request, Kelley secured from respondent's Chicago office and delivered to Hubbell Exhibit B-23 and Exhibits B-25 to B-34, inc. Exhibit B-23 was a tabulation showing the amounts of bonds originally issued in the various improvement districts, the number of bonds previously redeemed, and the number outstanding. (R. 171 and R. 465)

Exhibit B-25 was a rotogravure booklet of magazine size, issued by the Longview Co., a Long-Bell subsidiary and profusely illustrated with photographs of Longview. On the back of this Exhibit was a map which showed the location of The Long-Bell Lumber Company mills, the properties of the Weyerhaeuser Timber Company, and the City of Longview extending along the northerly side of the Columbia River. The corporate limits of the city were not shown. The map bore a legend reciting, that it

> "is intended to show in a general way the relation of the various parts of the city site to each other, and location of the city in relation to water, railroad and highway transportation facilities."

Exhibit B-27 was a reprint of an advertisement published in the Saturday Evening Post, with an illustration of extensive manufacturing plants, beneath which appeared:

> "The thoroughly modern, electrically operated manufacturing plants shown in the above sketch are in Longview, Wn. They produce 1,800,000 feet of Douglas fir lumber a day. The buildings cover 72 acres."

Exhibit B-28 is a descriptive booklet issued by the Longview, Wash. Chamber of Commerce, profusely illustrated. The booklet stated:

"Because Longview has proven by thorough investigation to offer those essentials necessary for successful industry, great manufacturing enterprises have made, and are making investments in this new industrial city. Appreciation of the many facilities of the site first led the Long-Bell Lumber Company to select it for the greatest lumber manufacturing plants in the world. The Weyerhaeuser Timber Company, largest lumber concern in the United States, has within the past two years built and put into operation a plant of three great mills on a 700 acre site on the Longview water front.",

From the offering circular and other exhibits Hubbell understood that the industrial plants referred to were inside the corporate limits, and subject to assessment in those improvement districts which embraced substantially the whole city. (R. 172) Kelley informed Hubbell that the limits of Local Improvement Districts #19 and #11 were co-extensive with the limits of the city. (R. 174)

The Long-Bell and Weyerhaeuser mill properties each represented an investment of about $10,000,000 and the Longview Fibre Company about $2,500,000 in 1930. (R. 213) The Long-Bell, Weyerhaeuser, Longview Fibre and Standard Oil Company plants were all outside the limits of Longview, and were not subject to assessment in any of the improvement districts. (R. 212) The mill properties were between the Columbia River and the limits of the city. The city never had a frontage of 7¼ miles upon the Columbia River, and in fact no frontage at all except for a very short distance adjacent to the Port of Longview dock. (R. 212)

On May 14, 1930 Frank Wood, respondent's Chicago sales manager, wrote Hubbell a letter, Exhibit B-24 (reproduced R. 466) in which respondent offered petitioner $100,000 par value of the Longview bonds in exchange for a like amount of State of Louisiana Highway bonds, maturing in March 1931, $85,000 of the bonds to be immediately delivered, and $15,000 for delayed delivery. This letter concluded:

"We believe you have before you practically all the data covering this issue of bonds, but if you have any questions in mind, we shall be pleased, indeed, to have you call Mr. Kelley or this office for anything you may need.

You observe, of course, that this city has no funded debt other than these improvement bonds, and that the original debt has been materially reduced through retirement and maturity."

Practically every lot and parcel of land included within the local improvement districts of Longview was also included within a diking district known as Cowlitz County Consolidated Diking District No. 1. (R. 264) In May, 1930, there were outstanding $2,554,000 of Diking District Bonds payable from the proceeds of special assessments levied upon lands within the district. (R. 264, 265)

Respondent well knew of the outstanding diking district bonds, for it had purchased from Long-Bell and resold the entire diking district bond issue in 1925. (R. 76, 77)

Kelley delivered to Hubbell a consolidated balance sheet of Long-Bell, and subsidiaries, as of December 31, 1929. (Exhibit B-34, R. 467-478, inc.) This balance sheet disclosed total assets of $116,183,706, of which current assets, comprising cash and inventories were $15,831,180. Current liabilities, including bank loans of $4,000,000, were $7,795,940. Funded debt of the corporation and all subsidiaries was shown as $41,794,042, and capital and surplus in excess of $59,000,000.

R. E. Simond, one of respondent's vice presidents, called as a witness by petitioner under Rule 43-b of the Rules of Civil Procedure, testified that in purchasing the local improvement bonds, respondent gave no consideration to the assessments against Longview real estate; that because of the unsatisfactory record of such bonds, respondent did not, and would not have considered them as predicated simply upon the real estate security; that respondent re-

garded the Long-Bell guarantee as the sole justification for handling the bonds. (R. 74-81) Respondent knew that the assessed valuations of lands within the various districts in 1925 and subsequent years were very low. (R. 80) It paid no attention to the valuations of lands in the districts because the bonds were purchased solely on the Long-Bell guarantee. (R. 80) These facts were never communicated to petitioner. (R. 315)

On June 4, 1930, Wood, respondent's Chicago sales manager, again wrote Hubbell that a proposed purchase of Long-Bell's subsidiary railroad by trunk lines in the Pacific Northwest indicated the importance of the City of Longview. (R. 483) This letter also stated:

> "Incidentally, I think you might be interested in knowing that within the past few days they have undertaken the retirement of a very substantial amount of Long-Bell Lumber Company mortgage bonds from funds which became available from the sale of capital assets not necessary to the successful operation of the company."

On May 17, 1930, petitioner, upon Hubbell's recommendation, purchased $85,000 of the local improvement bonds, exchanging a like amount of State of Louisana Highway bonds which had a market value slightly above par. On May 26, 1930 it exchanged $15,000 of Louisiana Highway bonds for a like amount of Longview local improvement bonds. On various dates in August, September and October, 1930, petitioner purchased $35,000 of such bonds for cash, at a price of 99 3/4, and on October 17, 1930, exchanged $200,000 of Chicago tax anticipation warrants, having a value slightly above par, for a like amount of Longview improvement bonds. In all, petitioner purchased $353,000 of Longview local improvement bonds from respondent. (Exhibit B-35, R. 479) Of these, $219,000 were bonds of District #11, and $60,000 were bonds of District

#19. These are the two districts which embrace the whole City of Longview. (R. 479)

All negotiations were conducted in Des Moines, Iowa, which is approximately 2,000 miles from Longview, Washington. Petitioner made no independent investigation of the bonds before purchasing them. (R. 172)

A close business relationship existed between Long-Bell Lumber Company and respondent in the years preceding 1930. Between 1922 and 1926 respondent purchased from Long-Bell and resold more than $25,000,000 of first mortgage bonds secured by liens upon standing timber, manufacturing plants and mill properties, including those located just outside the corporate limits of Longview. (R. 115) In 1925 respondent handled an issue of Cowlitz County Consolidated Diking District Bonds guaranteed by Long-Bell in the amount of $3,260,000. (R. 78) In 1926 respondent distributed $3,250,000 of Long-Bell collateral gold notes secured by pledge of bonds of a railroad subsidiary. (R. 116) In the offering circular of that issue respondent was referred to as the "fiscal agent" of Long-Bell. (R. 425) Respondent also bought from Long-Bell more than $3,000,000 of Longview local improvement district bonds issued in the years 1925, 1926 and 1927.

In November, 1927, respondent received advance notice that the directors of Long-Bell proposed to omit the quarterly dividend on the Class "A" stock of Long-Bell Lumber Corporation, a holding concern. (R. 155) In 1928 respondent conducted market operations in Long-Bell securities for which it asked $75,000 as compensation for bringing about an improvement in the market. (R. 88, 89, and see Exhibit B-5, reproduced at R. 431, 432) In January, 1930, respondent conferred with the Long-Bell officers with respect to a proposed merger of lumber manufacturers in the Pacific Northwest, (R. 91, 92) and see plaintiff's Exhibit B-6, (R. 433-435; in which the Long-Bell officers stated:

> "It is recognized that if the lumber industry of the Pacific Northwest is to be placed on a permanently stable and profitable basis, the desired economies effected and waste reduced, something more than the present individual and desultory attempts to regulate production, which regulation at best is only a temporary expedient to meet quickly an acute and distressing situation, must be accomplished."

In connection with its various purchases of Long-Bell securities, respondent sent three of its vice presidents, F. K. Shrader, C. T. MacNeille and Walter I. Sleep, to Longview. (R. 116 and 153) Sleep, in charge of municipal security purchases, was in Longview when the first local improvement issues were purchased. (R. 211, 212, and see Exhibit P-34, R. 513-515, inc.) Sleep died before the trial. Both Shrader and MacNeille testified, but neither of them denied knowledge that the Long-Bell and Weyerhaeuser mills were outside the corporate limits.

During the early months of 1930, respondent was informed that Long-Bell was endeavoring to sell its railroad subsidiary to certain trunk line railroads, to procure a large loan on another line of railroad at Weed, Cal., and to dispose of its power generating plant adjacent to Longview, which supplied power for lighting and domestic uses within the city, (R. 142) "to strengthen Long-Bell's current financial position by converting physical assets into working capital to meet current requirements." (R. 142)

In March and April, 1930, Long-Bell applied to respondent to market a bond issue for $150,000 on the Longview Daily News, a daily newspaper owned or controlled by Long-Bell, and to underwrite an issue of notes secured by pledges of instalment sales contracts for standing timber. (R. 92) On April 14, 1930, respondent's president, H. L. Stuart, advised R. A. Long, chairman of Long-Bell, that its credit was selling in the market on such a basis as to make it difficult, if not too costly, to undertake a sale of such

notes. (R. 93) On May 5, 1930, Stuart suggested to Long that he approach two New York banking houses for the desired financing, stating that these firms might be induced to make loans where the securities were not immediately marketable, but that they would probably demand a large commission or bonus. (R. 93, 94) On May 15, 1930, Long advised Stuart that he had been unable to secure the desired financing in New York. (R. 94, 95) In that letter Long stated to Stuart:

> "At the present, with business conditions as they are, we also need to strengthen our current position. If this could be done to an extent by accomplishing a disposition of the timber contracts, the importance of such a transaction is emphasized. Especially so, since we find the commercial bankers in a generally critical and sensitive attitude of mind. We, therefore, have the problem before us of meeting this situation, and doing everything possible to improve it so far as our position is concerned." (R. 95 and 436)

The matter of additional financing for Long-Bell was repeatedly brought up by the Long-Bell officers with respondent, until June, 1930. (R. 163, 164) On June 2, 1930, Shrader wrote Long that difficulties in the way of marketing any securities which "have anything to do with lumber, are so great as to make it almost impossible." (R. 165)

About May 5, 1930, the Long-Bell executives were advised by the Chase National Bank of New York that it would not continue Long-Bell's line of credit unless its current financial position could be strengthened. The Chase Bank suggested that a new subsidiary corporation be created to own all liquid assets and conduct borrowing operations with banks. (R. 129, 130) These suggestions were discussed with H. L. Stuart in the spring or summer of 1930. (R. 130, 148) Stuart commented that if Long-Bell found that it could carry commercial bank loans only by having a separate subsidiary, that was probably the thing to do. (R.

148, 149) On June 30, 1930 Stuart wrote Long, stating in part:

> "Perhaps your banks, except for Mr. Lonsdale's, had behaved themselves very well. (R. 441) * * * I am sure that Mr. Andrews gave you my message, which was to ask you to kindly let me know the outcome of your next talk with the Chase Bank." (R. 442, 105)

The Mr. Lonsdale referred to was the head of a St. Louis bank which had refused to renew Long-Bell's line of credit. (R. 105, 348)

It thus definitely appeared that respondent purchased the bonds solely upon the strength of the Long-Bell guarantee, and did not consider the real estate assessments as affording substantial security. In 1930 when these bonds were sold to petitioner, respondent and its officers well knew that the Long-Bell guarantee, which alone gave the bonds value, was seriously impaired, yet it offered the bonds to petitioner, stressing the location and importance of the City of Longview, and led petitioner to believe that Long-Bell was in financially sound condition.

In October, 1930, Long-Bell created a new subsidiary corporation, called Long-Bell Lumber Sales Corporation, to which it conveyed as of November 1, 1930, practically all its liquid and unencumbered properties, its retail sales yards and most of its cash. (R. 132) The Sales Corporation leased the mills and manufacturing plants and became the active company in dealing with the public, taking over substantially the entire active personnel of Long-Bell. (R. 133) The Lumber Company retained its encumbered property. (R. 133) In June, 1934, the Lumber Company filed a petition for reorganization under Sec. 77-B of the Bankruptcy Act. (R. 134) In December, 1935, by the terms of the decree of the United States District Court for the Western District of Missouri, the Lumber Company was relieved of its guaranty of the Longview local improvement bonds,

and Petitioner received, in lieu of such guaranty, 8.4 shares of common stock in the reorganized corporation for each $1,000 bond held by it. (Ex. B-53) This stock had a market value per share in December, 1935 of $8 bid, $12 asked. (R. 139)

Long-Bell defaulted in payment of the local improvement assessments upon lots and lands in the various local improvement districts in 1931, and also in payment of general taxes. Cowlitz County foreclosed its lien for general taxes in 1937, and received a tax deed in 1938 which wiped out the lien of the local improvement assessments. (R. 266-267)

Petitioner alleged fraud in four respects:

(a) The location of the industrial plants,

(b) The frontage upon the Columbia River,

(c) The Wood letter of May 14, 1930, and

(d) Making misleading statements as to the financial soundness of Long-Bell, while concealing and failing to disclose other facts which, if disclosed, would have changed the effect of the facts stated.

The District Court submitted the case to the jury, which awarded petitioner $66,150 damages, and judgment on the verdict was entered. (R. 625) The Circuit Court of Appeals for the Seventh Circuit reversed the judgment on the sole ground that no actionable fraud was shown. That court held that although the representations as to the industrial plants and the frontage upon the Columbia River were false and misleading, the evidence was insufficient to justify a finding that respondent knew that the statements were false. Although the false representations were contained in the exhibits submitted to Hubbell in response to his request for more information, since they were substantially the same as those set forth in the offering circular, the so-called "edge clause" relieved respondent from li-

ability for such statements. The Appeals Court likewise held that the statements of Wood that the city "has no funded debt other than these improvement bonds," and that "You have before you practically all the data," while carelessly made, were of trivial materiality, because the Long-Bell balance sheet, furnished to Hubbell, contained an entry that Long-Bell had guaranteed some diking bonds, the location of which was not shown, and that in any event, Hubbell was not misled, because he testified on cross examination that it was not his general custom, in 1930, in the purchase of municipal securities, to investigate the extent of bonds issued by overlapping municipalities. The court said that respondent's failure to disclose that it had handled the bonds solely on the basis of Long-Bell's guarantee, and would not have dealt with them at all without the guarantee, presented a more perplexing question, but that under the facts disclosed, there was no duty upon respondent to make such disclosure, since the parties were dealing at arm's length.

With respect to charges of fraud in concealing Long-Bell's true financial condition, the court said that the evidence presented only a failure to disclose facts, not amounting to fraud, and in any event, petitioner could, by proper investigation, have ascertained the true facts, and for these reasons, the District Court should have withdrawn the case from the jury. (R. 657-673) Timely petition for rehearing was filed and denied. (R. 699)

JURISDICTION.

1. The jurisdiction of this court to review the judgment and decision of the United States Circuit Court of Appeals for the Seventh Circuit is expressly provided for by Judicial Code, Section 240, as amended by the Act of February 13, 1925. This cause originated in the United States Dis-

trict Court, for the Northern District of Illinois, and an appeal was taken from the judgment of that court to the United States Circuit Court of Appeals. The jurisdiction of this court is, therefore, beyond question.

2. The date of the judgment sought to be reviewed is June 19, 1940. (R. 699) The opinion of the United States Circuit Court of Appeals for the Seventh Circuit was filed April 27, 1940, but petition for rehearing was filed and denied. (R. 657)

THE QUESTIONS PRESENTED.

The questions presented may be summarized as follows:

1. Does the inclusion by a dealer of a so-called "hedge clause" in an offering circular describing securities which states that the information therein contained is not guaranteed, but has been gained from sources believed to be reliable, and that the dealer has relied upon the facts stated in purchasing the securities, relieve such dealer from liability for false and fraudulent statements made by means other than the offering circular itself, particularly when it appears, by the admission of the dealer, that he dealt in the securities, not in reliance upon the facts set forth in the circular, but solely because the bonds were guaranteed by a corporation?

2. Is a dealer in securities, who knows that the securities which he offers for investment have no substantial value aside from the guarantee of a corporation, as a matter of law, free from actionable fraud, where he furnishes information indicating that the bonds are attractive investments and, at the request of the purchaser, supplies information indicating that the guarantor is in sound financial condition, and withholds the fact, known to him, that the guarantor is financially embarrassed, and about to transfer all its liquid and unencumbered properties to a new

subsidiary corporation for the purpose of preferring certain of its creditors?

3. Is a dealer in bonds and investment securities, as a matter of law, free from actionable fraud when the evidence discloses that in response to a request from a prospective purchaser for information concerning a corporation, which has guaranteed payment of principal and interest of a bond issue, he submits a balance sheet showing a relatively sound financial condition, and later solicits the purchaser to buy additional bonds of the same issue without disclosing the fact, which he has meantime learned, that the guarantor corporation has organized a new subsidiary to which it is about to transfer practically all its cash and unencumbered property, leaving the guarantor without means sufficient to perform the guarantee?

4. Was the Circuit Court of Appeals for the Seventh Circuit justified in ruling, as a matter of law, that the evidence was legally insufficient to support a finding that respondent knew of the falsity of the statements contained in the offering circular and other exhibits as to the corporate limits of Longview, Washington, and its frontage upon the Columbia River, in view of the fact that the record disclosed no denial of such knowledge by respondent's officers, and that it definitely appeared that three vice presidents of respondent had made trips to Longview for the purpose of investigating bond issues involving the properties as to which representations were made, and that respondent well knew the assessed values of properties in the various districts and in the entire City of Longview?

5. Was the Circuit Court of Appeals for the Seventh Circuit justified in ruling, as a matter of law, that statements by a seller of special assessment securities, that "We believe you have before you practically all the data covering this issue of bonds," and "You observe, of course, that (the municipality) has no funded debt other than these

improvement bonds," were of trivial materiality, where it definitely appeared that the seller had withheld from the purchaser material information in his possession as to other outstanding special assessment liens superior to the issue sold, and with respect to the financial condition of the guarantor of such securities?

6. Does the fact that a purchaser of securities makes no independent investigation concerning them, but relies upon the information given him by the seller, constitute a defense to a charge of fraud, where it appears that an independent investigation would have disclosed the falsity of the statements?

7. Was the Circuit Court of Appeals for the Seventh Circuit justified in ruling, as a matter of law, that the evidence was insufficient to support a finding of actionable fraud against respondent?

REASONS RELIED UPON FOR THE ALLOWANCE OF THE WRIT.

1. The Circuit Court of Appeals for the Seventh Circuit has decided an important question of local law of wide-spread general interest, in a manner directly in conflict with applicable local decisions, and in a manner having no support whatever in judicial precedent. The appeals Court held that the so-called "hedge clause", appearing in fine print at the bottom of all offering circulars issued by bond houses, relieved respondent from liability for misrepresentations contained in the other exhibits submitted to petitioner after it requested more information than was disclosed by the circular. The Appeals Court further holds that the hedge clause of the offering circular relieved respondent from liability for statements recklessly made, without knowledge of their truth or falsity. In these respects the opinion of the Circuit Court of Appeals is with-

out support in judicial precedent, and its effect is to lay down a rule of law which substantially exempts dealers in securities from all liability for false and fraudulent representations made to induce investors to purchase securities.

2. The Circuit Court of Appeals for the Seventh Circuit, in holding that the acts of respondent in furnishing the Long-Bell financial statement of January 1, 1930, in stating that petitioner had "all the data concerning the issue," and in writing the letter of June 4, 1930, indicating confidence in Long-Bell's financial position, created no obligation on respondent to disclose the true facts as to the financial situation of Long-Bell, has determined an important question of local Iowa law in a manner directly in conflict with applicable local decisions of the State of Iowa. The Appeals Court treated the allegations of fraud, based on Long-Bell's financial condition, as involving only silence of the respondent, upon whom no duty to speak was imposed. The Iowa rule, as established by *Noble v. Renner*, 177 Iowa 509, 159 N. W. 214; *Foreman v. Dugan*, 205 Iowa 929, 218 N. W. 912, and 23 American Jurisprudence, Fraud and Deceit, Paragraphs 93 and 94, is that silence on a subject may, under certain circumstances, constitute a false representation, as much as spoken words, and that one may be guilty of fraud by speaking half-truths, or by failing to speak fully, when furnishing information to be relied upon by the other party to the transaction.

3. The Circuit Court of Appeals for the Seventh Circuit has rendered a decision in this case on an important question of local law directly in conflict with the decisions of other circuit courts of appeal, and with long-established principles governing actions based upon fraud and deceit, as well as in conflict with the decisions of the Iowa Supreme Court. The decision in this case conflicts with that of *Loewer v. Harris*, 57 Fed. 368, (C. C. A. 2nd Cir.), wherein the rule was stated that when one party, pending nego-

tiations for a contract, holds out the existence of certain material facts, and learns, while negotiations are pending, that a change has occurred, of which the other party is ignorant, good faith and common honesty require him to correct the misapprehension which he has created.

The decision in this case is likewise directly in conflict with the decision of the Seventh Circuit Court of Appeals itself in *Cable v. United States Life Insurance Company*, 111 Fed. 19, in which the rule was laid down,

> "If one would deal at arm's length, he must remain silent. He may not speak that which is certain to deceive, and suppress that which would challenge attention disclosing the truth."

The decision of the Seventh Circuit Court of Appeals in this case is likewise directly in conflict with the decision of the Circuit Court of Appeals for the Fourth Circuit in *Thermoid Rubber Company v. Bank of Greenwood*, 1 Fed. (2) 891, which was a case dealing with the liability of a bank for furnishing misleading information concerning the credit standing of a third party. The court there held that furnishing facts which were true, but at the same time withholding information which materially changed the effect of the facts stated, constituted actionable fraud.

4. The Circuit Court of Appeals for the Seventh Circuit in its decision in this case has substituted its own judgment for that of the trial court and the jury upon conflicting facts, and in such respect has so far departed from the accepted and usual course of judicial procedure as to call for an exercise of the supervisory power of this court. The opinion of the Appeals Court holds that the representations that Longview had no funded debt "other than these improvement bonds," and that petitioner had "substantially all the data," were of "trivial materiality." These statements were contained in a letter written by respondent's sales manager to petitioner's vice president, making

formal offering of the Longview bonds. To hold that such statements are of "trivial materiality" is a very clear invasion of the province of the jury. The Appeals Court has likewise substituted its judgment, upon the facts, for that of the jury below in holding that the evidence that three vice presidents of respondent made trips to Longview for the purpose of investigating the Long-Bell mill properties and the diking and improvement districts was not sufficient to justify a finding by the jury that respondent knew that the mill properties were outside the corporate limits.

5. The Circuit Court of Appeals for the Seventh Circuit has in the decision of this case substantially applied the rule of *caveat emptor* to purchases by an investor of municipal special assessment securities, the subject matter of which is located at a point far removed from the place where the transaction was consummated, in violation of established principles of local law recognized by both state and federal courts. The rule of *caveat emptor* has never, until the decision of the Circuit Court of Appeals in this case, been applied to business transactions entered into upon the strength of representations concerning the credit and financial standing of third persons, and the rule has been well established that *caveat emptor* is without application where both parties do not have equal knowledge, or means of knowledge, concerning the subject matter. The decision of the Seventh Circuit Court of Appeals ignores these well established rules.

6. The Seventh Circuit Court of Appeals has based its decision in this case, in part at least, upon the fact that petitioner failed to investigate the securities, and failed to discover what an investigation might have disclosed. The Appeals Court decision in this respect rests upon a misapprehension of the Iowa law, and is directly in conflict with applicable local decisions of the Supreme Court of Iowa. The Iowa law is that negligence of a defrauded vendee

cannot be pleaded as a defense. See *Bean v. Bickley*, 187 Iowa 689, 174 N. W. 675, and *Ford v. Ott*, 186 Iowa 820, 173 N. W. 121.

A certified copy of the record in said suit in the United States Circuit Court of Appeals for the Seventh Circuit, including the record, proceedings, opinion and disposition of the cause had in said court, is herewith furnished and lodged in the office of the Clerk of this court in compliance with Rule 38 of the rules of this court.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of, and under the seal of this court, directed to the United States Circuit Court of Appeals for the Seventh Circuit, commanding that court to certify and to send to this court, for its review and determination, a full and complete transcript of the record and all the proceedings had in the case numbered and entitled on its docket as No. 7032, Equitable Life Insurance Company of Iowa, Appellee v. Halsey, Stuart & Co., Appellant, and that the said opinion and judgment of the United States Circuit Court of Appeals for the Seventh Circuit may be reversed by this court, and that petitioner have such other and further relief in the premises as to this court may seem meet and just.

EQUITABLE LIFE INSURANCE COMPANY OF IOWA,

By Joseph G. Gamble,

Alden B. Howland,

Attorneys for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

SUMMARY OF ARGUMENT.

I.

The so-called "hedge clause" of the offering circular in which respondent represented that "all statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we, ourselves, have relied upon them in the purchase of this security," cannot be construed to relieve respondent from liability for misrepresentations recklessly made through means other than the offering circular itself.

Davis v. Central Land Company, 162 Iowa 269, 143 N. W. 1073.

Haigh v. White Way Laundry Company, 164 Iowa 143, 145 N. W. 473.

A.

Since respondent did not purchase the local improvement bonds in reliance upon the security of the real estate assessments, as the circular indicated, the statement in the hedge clause that it did so, was essentially misleading, and was itself a fraudulent representation.

II.

The record shows that respondent was not merely silent with respect to the financial condition of Long-Bell, guarantor of the bonds, but indulged in half-truths, made affirmative statements and representations misleading in character, and by suppressing the true facts created a false and fraudulent impression as to the financial stability of Long-Bell. The conclusion of the Circuit Court of Appeals

that respondent was under no duty to disclose the true facts ignores established rules of law.

23 American Jurisprudence, Fraud and Deceit, Pars. 93 and 94.
Noble v. Renner, 177 Iowa 509, 159 N. W. 214.
Foreman v. Dugan, 205 Iowa 929, 218 N. W. 912.
Loewer v. Harris, 57 Fed. 368, (C. C. A. 2nd Cir.).
Cable v. United States Life Insurance Co., 111 Fed. 19 (C. C. A. 7th Cir.).

A.

Where positive representations are made which are true when made, but while the transaction is pending conditions substantially change, to the knowledge of the party making the original representations, good faith and common honesty require that the party making the representations advise the other that the change has taken place, and failure to disclose the fact of such change constitutes actionable fraud.

Loewer v. Harris, 57 Fed. 368, (C. C. A. 2nd Cir.).
Noble v. Renner, 177 Iowa 509, 159 N. W. 214.

III.

The conclusion of the court that the Wood letter of May 14, 1930, which stated "We believe you have before you practically all the data covering this issue of bonds," and "You observe, of course, that this city has no funded debt other than these improvement bonds," was of trivial materiality, substitutes the judgment of the court for that of the jury upon the weight of the evidence.

IV.

The rule of *caveat emptor* may not be applied to business transactions concerning the credit and financial standing of third persons. Even where one is under no obli-

gation to supply information as to the credit standing of a third person, if he voluntarily undertakes to do so, and leads the inquirer to believe that the credit of such third person is essentially different from the facts within his knowledge, and fails to disclose information vitally affecting the credit of such third person, he is liable for fraud to one extending credit to the third party upon the faith of such representations.

23 American Jurisprudence, pg. 869, Fraud and Deceit, Par. 89.
Iasigi v. Brown, et al., 17 Howard 183, 15 L. Ed. 208.
Thermoid Rubber Company v. Bank of Greenwood, 1 Fed. (2d) 891, (C. C. A. 4th Cir.).

V.

That appellee might have learned the true facts with respect to the location of the Long-Bell and Weyerhaeuser mills by independent investigation, or could have learned of Long-Bell's earnings from other sources, is no defense to a charge of fraud. The Iowa law (which governs this case) is that negligence of a defrauded vendee cannot be pleaded as a defense by a guilty vendor.

Bean v. Bickley, 187 Iowa 689, 174 N. W. 675.
Hetland v. Bilstad, 140 Iowa 411, 118 N. W. 422.
Ford v. Ott, 186 Iowa 820, 173 N. W. 121.
Martin v. Burford, 181 Fed. 922, (C. C. A. 9th).

ARGUMENT.

The record in this case discloses conduct upon the part of respondent, one of the nation's leading bond and investment houses, which should shock the conscience of any court. The holding of the Circuit Court of Appeals that no actionable fraud was shown by such conduct is all the more astounding, because in the main, and with some minor exceptions, the opinion of the Circuit Court itself discloses

the facts as developed upon the trial of the case. We have already in the foregoing petition for certiorari outlined the salient facts disclosed by the record. We shall endeavor in this argument, as briefly as possible, to demonstrate the wholly untenable character of the rules of law laid down by the Appeals Court in arriving at its decision that respondent was not shown to have been guilty of any actionable fraud.

I.

The so-called "hedge clause" of the offering circular in which respondent represented that "all statements herein are official, or are based on information which we regard as reliable, and while we do not guarantee them, we, ourselves, have relied upon them in the purchase of this security," cannot be construed to relieve respondent from liability for misrepresentations recklessly made through means other than the offering circular itself.

The Circuit Court of Appeals conceded that the statements of the offering circular with respect to the location of the industrial plants and the frontage of Longview upon the Columbia River were false and misleading, but held that such representations were improperly submitted to the jury because respondent had "guarded itself against liability for possible inaccuracy by the hedge clause in the prospectus," (R. 667) and because it concluded the evidence was insufficient to establish that respondent and its officers knew that the statements of the offering circular were false.

The conclusion of the Appeals Court that the evidence was insufficient to support a finding that respondent knew the true location of the industrial plants adjacent to the Longview corporate limits is not sustained by the record. The record shows that in the course of its dealings with Long-Bell, respondent sent three different vice presidents

to Longview for the purpose of investigating the security offered for issues of mortgage bonds totaling more than $25,000,000. A very vital part of this security were the immense lumber mills described as the "world's largest," which were located just outside the corporate limits of Longview. F. K. Shrader, respondent's vice president, made two trips to Longview in connection with the mortgage bonds, and MacNeille made some two or three. (R. 214) In addition, Walter I. Sleep, another vice president of respondent, made a trip to Longview in May, 1925, and there entered into a contract for the purchase of the first block of local improvement bonds which respondent purchased from Long-Bell. Other purchases were made in 1926 and 1927.

In addition to these facts, R. E. Simond, another vice president of respondent, through correspondence with Long-Bell's lawyer at Longview, learned in 1927 that the total assessed valuation of the whole City of Longview was $3,-439,918. The opinion of the court points out that the facts with reference to the location of the mills and the corporate limits of Longview were easily ascertained by petitioner's representative Windsor in 1931, on a one days trip.

In view of the number of issues of securities which respondent underwrote and handled for the Long-Bell interests, all of which were intimately connected with the City of Longview and the mill properties of Long-Bell, we submit that the conclusion of the Circuit Court of Appeals that no jury issue was presented as to respondent's knowledge of the location of the corporate limits of Longview, is clearly untenable. It is seldom, indeed, in fraud cases that knowledge of the true facts on the part of a defendant can be shown by direct admissions. In the great majority of cases guilty knowledge on the part of a defendant is established, just as it was in the case at bar, by proof of facts

and circumstances from which the conclusion that defendant did know the facts may be inescapably drawn.

But we desire the court to consider the question in a slightly different light. The opinion of the Circuit Court of Appeals in this case concedes that statements recklessly made by a defendant, without knowledge of falsity, for the purpose of inducing the other party to act, may be equally as culpable as statements made with full knowledge of their falsity. This is the rule which obtains in Iowa. In *Davis v. Central Land Company*, 162 Iowa 269, 143 N. W. 1073, the Iowa Supreme Court, in considering a charge of fraud based on representations as to the location of a boundary line between adjoining properties, said:

> "The fraud alleged consisted in the reckless assertion as true that of which the party knew nothing which was definitely ascertainable, and in deceiving the other party thereby. The principle is well established by the authorities, and the evidence was such as to carry the issue of fraud to the jury."

And see the later case of *Haigh v. White Way Laundry Company*, 164 Iowa 143, 145 N. W. 473, where in considering the sufficiency of the allegations of a petition with respect to the validity of a personal injury release, the Iowa Supreme Court said:

> "Where a false representation is relied upon as constituting fraud, it must be shown to have been knowingly made, with intent to mislead, or that the party made the statement as true, with no reasonable ground to believe it to be true, for the purpose of inducing the other to act. * * * So, in this case, it is immaterial whether or not the company, by its agent, knew or did not know whether the tendons of plaintiff's hand were in fact injured, for the reason that the defendant, through its agent, asserted it as a fact (and it was a material fact) for the purpose of inducing the plaintiff to believe it was true, and that her injuries were trifling; that she would soon recover. * * * The fraud

consists in asserting that to be true which was not true; which the defendant did not know to be true; made with the wrongful purpose and resulting in injury to plaintiff."

The record shows that petitioner's vice president, Hubbell, was not satisfied with the information contained in the offering circular, and requested that other facts be given him. In response to this request, the rotogravure magazine, the chamber of commerce booklet, and other data were supplied. These statements became representations made by respondent, and for that reason, even though it be conceded that the evidence did not show that respondent knew that the statements were false, a jury question was still presented upon the issue of the reckless character of the assertions.

A.

Since respondent did not purchase the local improvement bonds in reliance upon the security of the real estate assessments, as the circular indicated, the statement in the hedge clause that it did so, was essentially misleading, and was itself a fraudulent representation.

There is another aspect of the matter which we desire to call to the attention of this court, which was ignored by the Circuit Court of Appeals. The offering circular recited that respondent had itself relied upon the information set forth therein in the purchase of the securities. This statement was shown to have been false by the testimony of Simond, who said that respondent paid no attention whatever to the assessments and purchased the bonds solely because they were guaranteed by Long-Bell, and would have had nothing to do with them otherwise. By respondent's own admission the statement in the hedge clause itself was a false and misleading representation.

In the case at bar no officer or representative of respondent testified that he believed that the Long-Bell and Weyerhaeuser mills were within the city limits of Longview. It is true that one of the offering circulars, after its preparation, was shown to have been sent to the Long-Bell officers in Kansas City, Mo., for comment, and that the Long-Bell officers took no exception thereto, but respondent did know that it was not relying upon the real estate security in any degree in the purchase of the bonds, and it falsely stated that it had done so. Under these circumstances, no court has ever held that the so-called "hedge clause" constitutes a defense to misrepresentations, and we cannot believe that the decision of the Circuit Court of Appeals in this case is a correct statement of the rule of law which should govern.

II.

The record shows that respondent was not merely silent with respect to the financial condition of Long-Bell, guarantor of the bonds, but indulged in half-truths, made affirmative statements and representations misleading in character, and by suppressing the true facts created a false and fraudulent impression as to the financial stability of Long-Bell. The conclusion of the Circuit Court of Appeals that respondent was under no duty to disclose the true facts ignores established rules of law.

The Circuit Court of Appeals disposed of the claim of fraud based upon misrepresentations as to the financial condition of Long-Bell, guarantor of the bonds, as involving nothing more than a failure to disclose facts within respondent's knowledge. The court concluded that there was no duty upon the respondent, as a matter of law, to make disclosure of the facts within its knowledge, and that hence no actionable fraud was shown.

We may concede, of course, that a seller of securities is not bound to make any disclosure whatever concerning his knowledge of them to a prospective purchaser. Although he may know of facts which render the securities substantially worthless, we concede that the law is that he is guilty of no actionable fraud if he says nothing calculated to mislead or deceive a prospective purchaser, but when he elects to furnish information in response to inquiries, or otherwise, a dealer in securities is not at liberty to pick and choose the favorable facts, without revealing other facts which substantially change the effect of the facts stated.

In the course of its opinion the Appeals Court quoted with approval the text of 23 American Jurisprudence, Fraud and Deceit, Paragraph 93, in which the rule is stated that silence alone does not usually constitute fraud, but in the very next paragraph of the same work, we find this statement which is directly applicable to the case at bar:

> "Very little in addition to non-disclosure of material facts is required to prevent the application of the general rule which renders mere silence non-actionable and to make a party guilty of fraud. For instance, statements ordinarily regarded as expressions of opinion may be considered as sufficient where calculated to mislead and to prevent an examination of the property involved, or to throw the owner off his guard in order to gain the property from him. Indeed, it has been said that the least degree of misrepresentation constitutes very potent evidence of fraud, under such circumstances, and that a single word, a nod, a wink, a shake of the head, or a smile intended to induce the belief in the existence of a non-existing fact, may be sufficient."

No better statement of the true rule applicable to this case can be found than that contained in the opinion of the Seventh Circuit Court of Appeals itself in *Cable v. United States Life Insurance Company*, 111 Fed. 19, decided Octo-

ber 1, 1901. There Circuit Judge Jenkins, in a fraud case, involving the validity of a policy of life insurance, stated the rule in these words:

> "It is a general rule that meditated silence, there being no duty to speak, will not avail to avoid a contract. There being no duty to communicate intelligence, the one party is not bound to speak although he may know that the other party lies under a mistake. This is because the parties are dealing with each other at arm's length. But even in such case the *suppressio veri* must rest in silence, not in partial and misleading statement. The latter amounts to *suggestio falsi;* for, as has well been said, 'a half truth is often the greatest of lies.' If one would deal at arm's length, he must remain silent. He may not speak that which is certain to deceive and suppress that which would challenge attention, disclosing the truth. If the matter be with respect to a material fact, which, if known to the one party and not to the other, would, if disclosed, induce that other to refrain from contracting, either wholly or upon the terms proposed, the one having knowledge of the fact, if under no duty to disclose, may not by a partial statement throw the other party off his guard, when disclosure of the truth and the whole truth would have prevented his action."

That pronouncement of the Circuit Court has been expressly adopted by the Iowa Supreme Court in the case of *Noble v. Renner,* 177 Iowa 509, 159 N. W. 214.

Respondent in the case at bar was not merely silent with respect to the Long-Bell guarantee. It furnished a balance sheet and financial statement of Long-Bell as of January 1, 1930, with full knowledge that the financial condition thus disclosed had materially changed. On May 14, 1930 respondent's Chicago sales manager Wood wrote the letter, Exhibit B-24, in which petitioner was informed that it had been furnished "practically all the data covering this issue of bonds." This statement was clearly calculated to lead petitioner's officers to believe that it had received all of respondent's information concerning the issue.

In addition, it appears that on June 4, after the purchase of the first $100,000 of the Longview bonds, respondent's sales manager wrote a further letter, designated Exhibit B-40, and reproduced at R. 483. In this letter Wood stated that certain trunk line railroads operating in the Pacific North West might purchase Long-Bell's subsidiary railroad. With respect to this rumor Wood said:

> "This rather emphasizes not only the importance of this particular asset of the Long-Bell Lumber Company, but also the importance of Longview, Washington itself. Regardless of whether this does or does not take place, the reflection on Longview, Washington cannot be other than favorable.
>
> "Incidentally, I think you might be interested in knowing that within the past few days they have undertaken the retirement of a very substantial amount of Long-Bell Lumber Company mortgage bonds from funds which became available from the sale of capital assets not necessary to the successful operation of this company."

We have then in the case at bar, much more than mere silence upon the part of respondent. We have active misrepresentation, plus concealment, which brings the case clearly within the rule laid down by the authorities cited above. Respondent, through its sales department, by these half-truths, created an essentially false impression in the minds of petitioner's officers as to the financial and credit standing of Long-Bell.

We submit, therefore, that the opinion of the Circuit Court of Appeals is obviously wrong; that it is based upon a false premise and a misconception of the true rule of law which should govern this case.

A.

Where positive representations are made, which are true when made, but while the transaction is pending, conditions substantially change, to the knowledge of the party making the representations, good faith and common honesty require him to advise the other that the change has taken place, and failure to disclose the change constitutes actionable fraud.

There is another phase of this case which was wholly ignored by the Circuit Court of Appeals. The rule laid down both by the federal courts and by the Supreme Court of Iowa is in accord with the statement appearing in the preceding paragraph.

The Iowa Supreme Court in the case of *Noble v. Renner*, 177 Iowa 509, 159 N. W. 214, stated the rule under these circumstances as follows:

> "Even if representations are true when made, and they subsequently become false by change in the subject matter, it is the duty of the person who made these representations to inform the other, and if he fails so to do, he is guilty of fraud."

This rule has always obtained in the federal courts, and is well illustrated by the opinion of the Second Circuit Court of Appeals in *Loewer v. Harris*, 57 Fed. 368, in which that court stated the rule as follows:

> "The law requires disclosure to be made only when there is a duty to make it, and this duty is not raised by the mere circumstance that the undisclosed fact is material, and is known to the one party and not to the other, or by the additional circumstance that the party to whom it is known knows that the other party is actually in ignorance of it; but when one of the parties, pending negotiations for a contract, has held out to the other the existence of a certain state of facts material to the subject of the contract, and knows that

> the other is acting upon the inducement of their existence, and, while they are pending, knows that a change has occurred of which the other party is ignorant, good faith and common honesty require him to correct the misapprehension which he has created. It becomes his duty to make disclosure of the changed state of facts, because he has put the other party off his guard. The doctrine is thus stated by Mr. Pollock, in his work, Principles of Contracts, page 491: 'It is sufficient if it appears that the one party knowingly assisted in inducing the other to enter into the contract by leading him to believe that which was known to be false. Thus it is where one party has made an innocent misrepresentation, but, on discovering the error, does nothing to undeceive the other."

If there be any question in this record as to respondent's knowledge of the true financial picture of Long-Bell at any time, it is abundantly established that respondent did have full knowledge of the demands of commercial bankers some time prior to June 30, 1930. In the months of August and September, 1930, in reliance upon the original statements, petitioner purchased from respondent $35,000 of local improvement district bonds, and in October, $202,000 of such securities.

The case at bar, therefore, comes squarely within the rule laid down by the authorities above cited. It is conceded that Halsey, Stuart never transmitted to petitioner the fact that the Long-Bell guarantee had become impaired. The opinion of the Circuit Court of Appeals for the Seventh Circuit holds that there was no duty to make this disclosure. We submit that such a rule of law is preposterous as applied to modern conditions, and particularly as applied to the purchase of a block of municipal securities of a city located 2,000 miles distant from the place where the transaction is consummated.

The decision of the Circuit Court of Appeals strictly applies to this case the doctrine of *caveat emptor*. This an-

cient rule, while not without proper application, has been distinctly repudiated by practically every court in the land as applied to transactions where the parties are dealing with subject matter not readily accessible, and particularly where the subject of the representations is the financial standing or credit of a third party. For these reasons we say that the opinion of the Circuit Court of Appeals is so clearly untenable, so contrary to the rules of law laid down by the courts in modern times, that the supervisory power of this court should be exercised for the purpose of reviewing the judgment below.

III.

The conclusion of the court that the Wood letter of May 14, 1930, which stated, "We believe you have before you practically all the data covering this issue of bonds", and "You observe, of course, that this city has no funded debt other than these improvement bonds," was of trivial materiality, substitutes the judgment of the court below for that of the jury upon the weight of the evidence.

The Circuit Court of Appeals pointed out in its opinion that the statements contained in the Wood letter of May 14, 1930 were careless; that the letter implied that the bonds involved were part of the funded debt of the city, and that there were no other obligations equal or superior to them. The court concluded, however, that, in view of Hubbell's statement on cross examination, that in purchasing municipal issues, he did not, as a general custom, pay attention to overlapping municipal sub-divisions, the materiality of the letter and its possible implications were trivial.

Hubbell, petitioner's vice president, knew Wood, and knew that he was a responsible officer of Halsey, Stuart & Co. The Wood letter was written, according to the testi-

mony of respondent's salesman Kelley, at Hubbell's request. Were not these statements, under the circumstances disclosed, something more than mere careless sales talk? Would not any well informed purchaser of bonds understand from the plain recitals of this letter that he had received all material facts in respondent's possession, and that the issue constituted the only outstanding assessment securities of the City of Longview?

Petitioner was informed that more than one-third of the bonds originally issued had been retired, and that only $2,000,000 remained outstanding. Had these been the only special assessment liens upon the property, the situation would have been vastly different. The diking district bonds amounting to $2,554,000, were outstanding, and were principally secured by liens upon the properties within the City of Longview. These facts make it clear that the representation that there were no other securities outstanding was vitally material as an inducement to petitioner to purchase the bonds.

Respondent was not merely silent with respect to the existence of the diking district bonds and assessments. There was a direct, positive representation that there was no other funded debt "other than these bonds." Had the quoted portion of the statement been omitted, the representation would have been true, but as made, the statement is directly calculated to lead a prospective purchaser to believe that there were no other outstanding bonds in Longview.

Under these circumstances, we submit that the Wood letter was definitely material, and that it was proper for consideration by the jury. The Circuit Court of Appeals has not ruled that the letter should have been excluded from evidence, but that is the necessary result of the decision. It seems to us very clear that the Circuit Court of Appeals has merely substituted its own judgment for that

of the jury below as to the weight to be accorded the Wood letter. This is obviously beyond its province.

IV.

The rule of caveat emptor may not be applied to business transactions concerning the credit and financial standing of third persons. Even where one is under no obligation to supply information as to the credit standing of a third person, if he voluntarily undertakes to do so, and leads the inquirer to believe that the credit of such third person is essentially different from the facts within his knowledge, and fails to disclose information vitally affecting the credit of such third person, he is liable for fraud to one extending credit to the third party upon the faith of such representation.

The Circuit Court of Appeals, as we have already seen, applied the rule of *caveat emptor* to the purchase of Longview improvement bonds by petitioner. In this respect the decision below is a distinct departure from every case which we have examined on the subject. The courts, both state and federal, have long recognized that the rule of *caveat emptor* cannot be applied to representations concerning the financial standing or credit of a third person, and the cases cited in the Summary of Argument fully bear out this contention.

V.

That Petitioner might have learned the true facts with respect to the location of the Long-Bell and Weyerhaeuser mills by independent investigation, or could have learned of Long-Bell's earnings from other sources, is no defense to a charge of fraud. The Iowa law (which governs this case) is that negligence of a defrauded vendee cannot be pleaded as a defense by a guilty vendor.

The Circuit Court of Appeals points out in its opinion (R. 671, 672) that petitioner made no independent investigation concerning the Longview bonds; that when it became suspicious and sent a representative to Longview, it was able to find out the facts at once, and "there is nothing to suggest why it could not have found them with equal facility before it purchased the bonds." The court also points out that had petitioner resorted to the financial news services in May and July, 1930, it could have learned that Long-Bell had incurred operating losses in the early months of that year.

The Circuit Court of Appeals considered the facts set forth above as of major importance. They were utterly immaterial under the rule of law which has long obtained in Iowa, for it is well established that contributory negligence on the part of a defrauded purchaser is no defense. In *Ford v. Ott*, 186 Iowa 820, 173 N. W. 121, the Iowa Supreme Court stated the rule in this language:

> "The law will not allow one committing a fraud to protect himself by the claim that his victim was easily deceived, and did not act in the matter with reasonable prudence."

Furthermore, had petitioner resorted to the financial news services it would have learned merely that Long-Bell had sustained operating losses in the first and second quar-

ters of the year 1930. While these facts were of considerable importance, as indicating the trend of Long-Bell business, still they were but minor items compared with the contemplated dismemberment of the Long-Bell organization, and the creation of the new Sales Corporation for the purpose of placing the bank creditors of Long-Bell in preferred position.

The Circuit Court of Appeals has, we submit, wholly disregarded the Iowa decisions on this phase of the case.

It is therefore respectfully submitted that this case is one calling for the exercise by this court of its supervisory powers over the judgments and decrees of Circuit Courts of Appeal. In order that the errors committed by the Seventh Circuit Court of Appeals may be corrected and that petitioner may have the benefit of the rights to which it is entitled under the laws of Iowa a writ of certiorari should be granted and this court should review the decision of the Seventh Circuit Court of Appeals and finally reverse it.

Respectfully submitted,

JOSEPH G. GAMBLE,

ALDEN B. HOWLAND,

Attorneys for Petitioner.